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DOW THEORY LETTERS

"THE MARKET AS INTERPRETED UNDER THE DOW THEORY"

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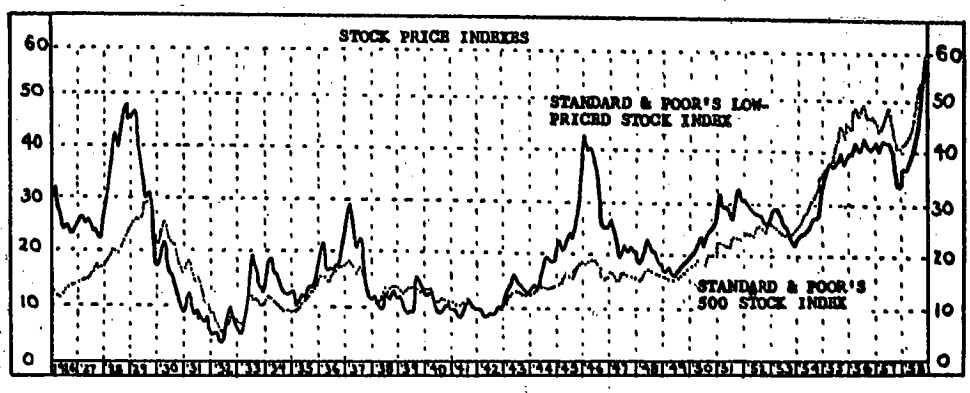
WILLIAM P. HAMILTON'S FORECASTS. A number of readers have asked how one would have fared over a long period of time if one had followed and acted on really competent Dow Theory forecasts. In 1932, amid the disillusionment of the Great Depression, the Cowles Committee attempted to discredit market forecasting in all its forms. Many market methods and techniques received rough treatment from the authors of the well known Cowles report. Using Hamilton as the accepted leader of the Dow Theory method of market forecasting, the Committee was forced to admit that "Our analysis of the Dow method, as interpreted by Hamilton, reveals a distinctly satisfactory record." A hint as to the nature of this "satisfactory record" may be obtained from a letter which Mr. Cowles later wrote to a magazine called Stock Market Technique. "The total profit which would have been made in the 26 years, by applying Hamilton's forecasts to the stocks of the Dow-Jones Industrial averages was 1804.95%." This latter percentage equals 69% per year over the 26 year period. This writer would call Hamilton's forecasting method a little better than "satisfactory" but remember, the Cowles Committee was not exactly promoting the art of market forecasting.

WHITHER THE "CATS-AND-DOGS? Many subscribers, having purchased one or a few low-priced stocks, now wonder when some of their laggard selections will start moving. Those readers who own "cats-and-dogs" that have made major moves are asking how far their stocks will travel. At this point, a survey of the previous market action of low-priced stocks may be profitable. In studying the chart below, it is obvious that there have been four distinct upsurges in low-priced issues since 1926. (1) In the giant 1921-29 bull market, cheap stocks as compared to the general market (we will use S.&P's 500 Stock Index as the market) made a huge advance as late as 1928. Two years later the bull market had collapsed. (2) During the 1932-37 bull market, the "cats-and-dogs" made their real move toward the end of 1936. One year later that market topped out. (3) The 1942-46 bull market did not see a phenomenal rise in cheap stocks until late 1945. By the end of 1946 the bears had taken charge. (4) Starting in October, 1957, the low-priced issues headed upwards. Subscribers who have followed our reasoning know that this recent rise in cheap stocks marks the beginning of the third and last phase of this unprecedented bull market. No one can forecast exactly how long this final phase will last, but it is the author's opinion that we have another few years to go. Note that so far in the present third phase, as compared to the third phase of previous bull markets, the low-priced stocks have not really advanced very far above the 500 Stock Index. Historically, this move has not occurred until the last year to year and a half of the entire bull market. Readers who care to risk a repetition of history (and I believe it is a good risk) may buy low-priced issues here, and sit them out. But real patience is needed. The following seem to me to be good choices: AVCO, HOTEL CORP., CALLAHAN MINING, AMERICAN CABLE, WELBILT, GENERAL INSTRUMENT, F.L.JACOBS, SPARTON, CONTINENTAL MOTORS, HUPP, CURTIS PUBLISHING, STUDEBAKER-PACKARD, SYMINGTON-WAYNE, BALDWIN-LIMA-HAMILTON, UNITED MERCHANTS, ADMIRAL.

DOW THEORY. In my last letter I ended by saying "After perpendicular rises such as we have witnessed in the last month, it is perfectly normal for a sharp decline to correct at least 1/3 to 2/3 of the rise since the Oct. lows (A-on chart)." I added that at that time, volume indications seemed to indicate that the market would hold. On Nov. 18 (point B) rails advanced to new highs for the year. This rail breakout was unconfirmed by industrials despite the fact that volume was high on the move and industrials had a mere $2.00 more to go for a confirmation.



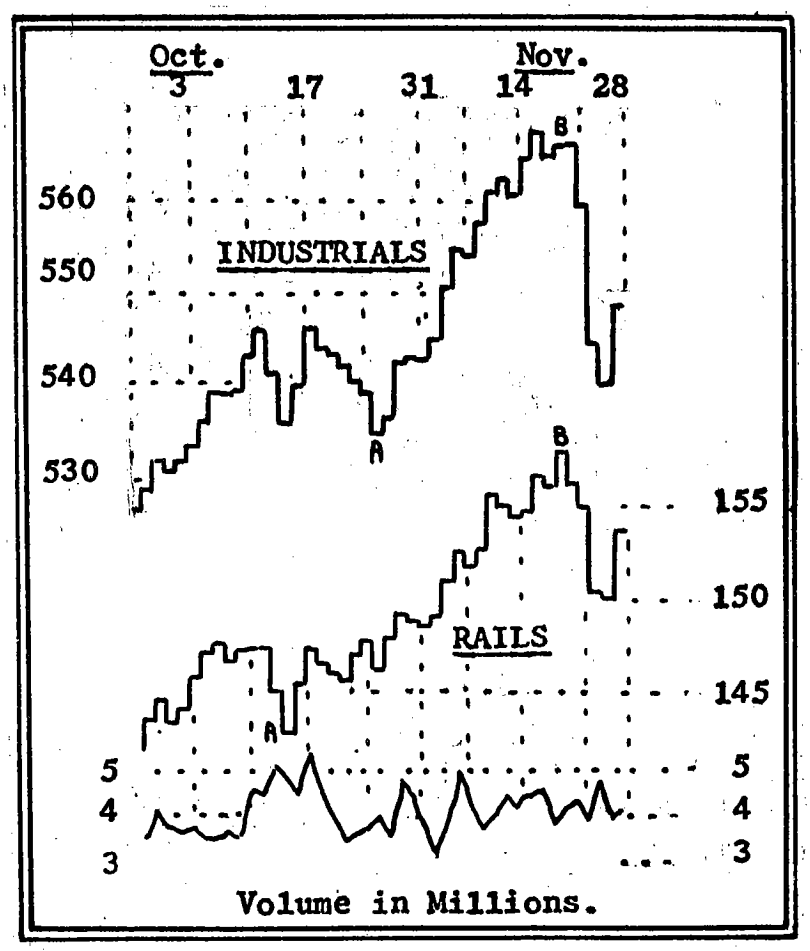
On Nov. 21, 24, and 25 a steep decline of three days wiped out all of the industrial gains of the previous 16 days. Because of the severity of this down-move, it must be considered a panic decline, correcting the advance since the October lows. Of the market action following a panic Hamilton says,

> "It is a uniform experience, over the years..., that a panic decline is followed by a sharp rally of 40% to 60% of the movement, and then by an irregular sag ultimately carrying the price to about the old low point. It seems to need this to bail out the weak holders who were helped over the panic."

On Tuesday, rails showed signs of resisting a further decline and backed off a mere .22¢ to the $4.37 of the industrials. Volume also declined sharply from Monday's figure. As noted in the last few letters, the rail formation with its many consolidations and little ascending bases, is a more bullish structure than the industrial pattern. Therefore it was not surprising to see that, as of Tuesday, industrials had lost 85% of their gain since point A while rails lost less than 50%. Wednesday saw the turn as industrials surged $8.67 and rails $3.67 on increasing volume. The odds are that the averages will advance about 40-60% from the panic lows, which would take rails to 153-4 and industrials to 551-6. After making their advance it is most probable that an irregular decline will test the panic lows of 150.19 (rails) and 540.72 (industrials.) If volume tends to diminish on this decline, and one or both averages remain above the panic lows, it will be a bullish indication and stocks may be bought. If the two lows are violated on increasing volume (I do not believe they will) traders could safely take profits.

Readers may be consoled by the knowledge that the timing of the recent move is typical of a bull market. In bull markets, the advances tend to be long and tedious, the reactions short and rapid. In bear markets the exact opposite is true.

The following stocks show good technical patterns and may be bought during the "buy" period outlined above...
NEW YORK CENTRAL, PENN. R.R., MAGNAVOX, U.S. STEEL, REPUBLIC STEEL, COPPERWELD STEEL, POLAROID, MACK TRUCK, TEXAS CO., STANDARD OIL OF CALIF., CELANESE, AMERICAN AIRLINES, FRAUHAUF TRAILER, STONE & WEBSTER, OWENS-ILLINOIS GLASS.



IMPORTANT NOTICE.

All subscribers and followers of the Dow Theory will be interested in the author's full-length article which will appear in BARRON'S this Monday, December 1st. BARRON'S is the Dow-Jones weekly. The article covers some basic Dow Theory and explains why we are now in the third phase of a bull market.